KPMG

Consolidated Financial Statements of

THE SAUCY BREAD COMPANY INC.

(Formerly Viropean Ventures Inc.)

Years ended December 31, 1998 and 1997

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AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of The Saucy Bread Company Inc. (formerly Viropean Ventures Inc.) as at December 31, 1998 and 1997 and the consolidated statements of operations and deficit and changes in financial position for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 1998 and 1997 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Calgary, Canada
February 26, 1999

THE SAUCY BREAD COMPANY INC.

(Formerly Viropean Ventures Inc.)

Consolidated Balance Sheets

December 31, 1998 and 1997

	1998	1997
Assets		
Current assets:		
Cash	$ 106,645	$ 176,403
Accounts receivable	47,845	13,060
Marketable securities (market value - $nil; 1997 - $45,154)	–	36,956
Inventory	60,844	13,902
Prepaid expenses and deposits	3,554	9,851
	218,888	250,172
Capital assets (note 5)	1,134,895	540,156
Intangible assets (note 6)	10,237	10,680
Deferred product development costs (note 7)	–	8,867
	$ 1,364,020	$ 809,875
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 211,590	$ 22,233
Current portion of long-term debt (note 8)	51,253	22,104
	262,843	44,337
Long-term debt (note 8)	180,625	195,979
Convertible debentures (note 9)	400,000	–
Advances from related parties (note 10)	–	58,479
	843,468	298,795
Shareholders' equity:		
Share capital (note 11)	1,453,767	749,138
Deficit	(933,215)	(238,058)
	520,552	511,080
Commitments (note 15)		
Subsequent events (note 17)		
	$ 1,364,020	$ 809,875

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board:

________________________ Director

________________________ Director

THE SAUCY BREAD COMPANY INC.

(Formerly Viropean Ventures Inc.)

Consolidated Statements of Operations and Deficit

Years ended December 31, 1998 and 1997

	1998	1997
Sales	$ 807,987	$ 378,504
Costs and expenses:		
Restaurant expenses	613,836	247,516
General and administration	409,666	143,542
Food and beverage costs	308,266	103,500
	1,331,768	494,558
Loss before the following	523,781	116,054
Interest on long-term debt	34,132	8,275
Other expenses	6,827	4,233
Other interest and bank charges	4,520	2,640
Depreciation and amortization	125,897	29,011
Net loss	695,157	160,213
Deficit, beginning of year	238,058	77,845
Deficit, end of year	$ 933,215	$ 238,058
Net loss per Common Share	$ 0.05	$ 0.02

See accompanying notes to consolidated financial statements.

1. General:

The Saucy Pretzel Inc. ("Saucy Pretzel") was incorporated under the Business Corporations Act (Alberta) as 659191 Alberta Ltd. on June 23, 1995 and changed its name to The Saucy Pretzel Inc. on August 25, 1995. On April 15, 1998 Saucy Pretzel was acquired by Viropean Ventures Inc. ("Viropean"), a corporation incorporated under the Business Corporations Act (Alberta) on June 15, 1990. Viropean changed it's name to The Saucy Bread Company Inc. (the "Corporation") on April 16, 1998.

The Corporation retails and wholesales baked bread products sold primarily in a retail fast-food environment.

The Corporation is in the start-up phase and is not yet able to finance its operations internally. Future viability of the Corporation is dependent on the ongoing support of shareholders as well as further equity capital financing and profitable future operations.

2. Basis of presentation:

(a) Consolidated financial statements:

The consolidated financial statements include the accounts of the Corporation and its wholly-owned subsidiaries.

(b) Business combination:

Effective April 15, 1998 Viropean acquired all of the issued and outstanding common shares of Saucy Pretzel through the issue of 10,715,550 Common Shares pursuant to the terms of a commitment agreement entered into on November 18, 1997.

As a result of this acquisition, the previous shareholders of Saucy Pretzel as a group acquired more than 50% of the issued and outstanding shares of Viropean. Accordingly, this business combination has been accounted for as a reverse takeover, whereby, notwithstanding the legal acquisition of Saucy Pretzel by Viropean, the transaction was accounted for as an acquisition of Viropean by Saucy Pretzel.

2. Basis of presentation (continued):

(b) Business combination (continued):

Application of reverse takeover accounting results in the following:

(i) The consolidated financial statements are issued under the name of the legal parent (the Corporation) but are considered to be a continuation of the financial statements of the legal subsidiary, Saucy Pretzel;

(ii) As Saucy Pretzel was deemed to be the acquirer for accounting purposes, its assets and liabilities were included in the consolidated financial statements at their historical carrying values;

(iii) The financial year end of Viropean was changed to December 31;

(iv) Control of the net assets and liabilities of Viropean is deemed to be acquired by Saucy Pretzel. For the purpose of this transaction, the deemed consideration is the fair value ascribed to the approximate number of Common Shares of Viropean outstanding immediately prior to the transaction plus estimated transaction costs; and

(v) For the purpose of computing net loss per Common Share, the number of shares outstanding for the period from the beginning of the year to April 15, 1998, the date of the reverse takeover, is deemed to be the number of shares issued by Viropean to the shareholders of Saucy Pretzel. For the period from April 15 to December 31, 1998, the number of shares used in the calculation is the actual weighted average number of shares of the Corporation outstanding in that period.

For comparative purposes, net loss per Common Share is calculated by dividing the loss of Saucy Pretzel by the number of shares of Viropean issued in the reverse takeover transaction.

3. Significant accounting policies:

(a) Inventory:

Inventory is valued at the lower of cost and net realizable value.

3. Significant accounting policies (continued):

(b) Capital assets:

Capital assets are recorded at cost. Depreciation is provided from the month of purchase using the following rates for all assets except computer software which records half year depreciation in the year of acquisition:

Assets	Method	Rate
Equipment	Declining balance	10%
Leasehold improvements	Straight-line	10%
Computer software	Declining balance	100%
Computer hardware	Declining balance	30%
Signage	Declining balance	10%
Automobiles	Declining balance	10%

(c) Intangible assets:

Intangible assets are recorded at cost. Amortization is provided on a straight-line basis over ten years.

(d) Deferred product development costs:

The Corporation capitalizes costs related to the development of new products. Such costs are amortized on a straight-line basis over three years upon commencement of commercial sale of the product. If the product is later determined not to be commercially viable, those costs are written off. All ongoing costs with respect to the continuing product development is charged to earnings in the current year.

(e) Net loss per Common Share:

Net loss per Common Share is calculated using the weighted average number of Common Shares deemed or actually outstanding during the year. Fully diluted loss per share is not shown as there are no material dilutive factors.

(f) Foreign currency:

Monetary items denominated in foreign currency are translated to Canadian dollars at exchange rates in effect at the balance sheet date and non-monetary items are translated at rates of exchange in effect when the assets were acquired or obligations incurred. Revenues and expenses are translated at rates in effect at the time of the transactions. Foreign exchange gains and losses are included in operations.

3. Significant accounting policies (continued):

(g) Income taxes:

The Corporation follows the deferral method of income tax allocation whereby income taxes are provided based on income included in the financial statements regardless of when such income is subject to payment of taxes under the tax laws. Deferred income taxes result from the timing differences between deductions claimed for income tax purposes and deductions recorded in the accounts.

(h) Use of estimates:

A precise determination of many assets and liabilities is dependent upon future events, therefore the preparation of consolidated financial statements for a period necessarily involves the use of estimates and approximations which have been made using careful judgment.

4. Business combination:

As explained in note 2, the acquisition of Saucy Pretzel has been accounted for as a reverse takeover. The purchase price is based on the fair values of the assets and liabilities acquired. Accordingly, the accounting for the business combination on this basis is summarized as follows:

Deemed consideration	$	132,129
Net assets acquired:		
Cash and term deposits	$	139,121
Accounts receivable		6,118
Accounts payable		(13,110)
	$	132,129
Excess of deemed consideration over net assets acquired	$	–

These consolidated financial statements include the revenues and expenses of Saucy Pretzel from January 1, 1998 and revenues and expenses of Viropean from April 15, 1998, the effective date of the business combination.

5. Capital assets:

1998	Cost	Accumulated depreciation	Net book value
Equipment	$ 628,037	$ 54,000	$ 574,037
Leasehold improvements	570,493	42,898	527,595
Computer software and hardware	26,348	13,792	12,556
Signage	15,220	2,488	12,732
Automobiles	11,702	3,727	7,975
	$ 1,251,800	$ 116,905	$ 1,134,895

1997	Cost	Accumulated depreciation	Net book value
Equipment	$ 268,926	$ 12,717	$ 256,209
Leasehold improvements	275,072	17,072	258,000
Computer software and hardware	11,830	1,972	9,858
Signage	8,410	1,182	7,228
Automobiles	11,702	2,841	8,861
	$ 575,940	$ 35,784	$ 540,156

Computer software and hardware at December 31, 1998 includes approximately $30,300 of assets under capital lease.

6. Intangible assets:

	1998	1997
Trademark	$ 11,575	$ 10,861
Accumulated amortization	(1,338)	(181)
	$ 10,237	$ 10,680

7. Deferred product development costs:

	1998	1997
Deferred development costs	$ –	$ 9,389
Accumulated amortization	–	(522)
	$ –	$ 8,867

8. Long-term debt:

	1998	1997
Term loan, repayable in one instalment of $900 on May 23, 1999 and 71 monthly instalments of $2,100 commencing June 23, 1999; bearing interest at the bank's operational rate plus 3% per annum and secured by a general security agreement and a limited guarantee of one shareholder	$ 150,000	$ 150,000
Bank loan, repayable in monthly instalments of $1,792 to February 5, 2001, bearing interest at the bank's prime rate plus 2.25% per annum and secured by a first fixed and floating charge on all assets and limited personal guarantees of two shareholders	46,583	68,083
Capital lease, payable in monthly payments of $964 over 48 months, commencing March 1998; an interest rate of 6.76% implicit in the lease, secured by the guarantee of a shareholder	35,295	–
	231,878	218,083
Less amounts due within one year	51,253	22,104
	$ 180,625	$ 195,979

Repayments of long-term debt over the next five years are as follows:

1999	$ 51,253
2000	57,008
2001	39,811
2002	27,106
2003	25,200
Thereafter	31,500
	$ 231,878

9. Convertible debentures:

During the year ended December 31, 1998 the Corporation issued convertible debentures in the amount of $400,000 maturing December 31, 2003 together with 400,000 share purchase warrants. Interest is payable on a quarterly basis at a rate of 14% per annum. The debentures are convertible, at the option of the holder, into Common Shares of the Corporation at conversion prices as follows:

To December 31, 1999	$	0.36
To December 31, 2000		0.41
To December 31, 2001		0.46
To December 31, 2002		0.55
To December 31, 2003		0.65

After December 31, 2000 and 30 days notice, the debentures are redeemable for cash at the option of the Corporation at an amount equal to the principal plus accrued and unpaid interest. The debentures are unsecured. Each share purchase warrant entitles the holder to acquire one Common Share at a price of $0.50 per Common Share and expires on December 31, 2000.

10. Advances from related parties:

During the year ended December 31, 1998 the advances from related parties were repaid in full. These funds were used to purchase shares of the Corporation under the private placements referred to in note 11.

11. Share capital:

(a) Authorized:

Unlimited number of Class A Common Shares

11. Share capital (continued):

(b) Issued:

	Number of shares	Amount
Balance, December 31, 1996	4,360,000	$ 14,790
Private placements	4,677,000	751,550
Exercise of stock options	480,000	12,000
Issue of shares for cash	200,000	5,000
Settlement of advances from related parties	200,000	5,000
Less share issue costs	–	(39,202)
Balance, December 31, 1997	9,917,000	749,138
Issue of shares for cash	703,550	140,714
Issue of shares for services	90,000	–
Less share issue costs	–	(25,000)
Balance, April 15, 1998, immediately preceding the reverse take-over transaction (note 4)	10,715,550	864,852
Outstanding common shares of Viropean at April 15, 1998	1,750,000	–
Issued on acquisition of Saucy Pretzel (note 4)	10,715,550	132,129
Private placements	2,430,000	544,636
Exercise of warrants	50,000	10,000
Less share issue costs	–	(97,850)
Balance, December 31, 1998	14,945,550	$ 1,453,767

(c) Warrants:

The Corporation has attached warrants to certain Common Shares issued. No value has been ascribed to these warrants. Each warrant entitles the holder to purchase one Common Share at a price of $0.20 to $0.35 per share at times ranging from April 1999 to December 2001. As at December 31, 1998 there were 630,710 (1997 - 200,000) warrants outstanding.

In addition 400,000 share purchase warrants issued in connection with the convertible debentures referred to in note 9 are outstanding at December 31, 1998.

(d) Stock option plan:

The Corporation has an incentive stock option plan which provides for the granting of stock options to directors, officers and employees to a maximum of 10% of the total issued and outstanding shares. At December 31, 1998 there were 1,175,000 (1997 - nil) options outstanding to acquire Common Shares with an exercise price of $0.25 per Common Share, expiring April 16, 2003.

11. Share capital (continued):

(e) Stock split:

Effective February 28, 1997 the Corporation split its issued and outstanding Common Shares on a four-for-one basis. All references in the consolidated financial statements with regard to the shares outstanding and the per share amounts have been restated to reflect this stock split.

12. Fair values of financial instruments:

The carrying values of the Corporation's current monetary assets and liabilities and long-term debt approximate their fair values due to their short-term maturities or floating interest rate terms.

The estimated fair value of the convertible debentures as at December 31, 1998 also approximates its carrying value. The estimated fair value of the debentures has been based on the present value of contractual future payments of principal and interest, discounted at the current market rates of interest available to the Corporation for the same or similar debt instruments. The estimated fair value does not incorporate the value that may be attributable to the conversion feature inherent in the debentures.

13. Related party transactions:

During the year ended December 31, 1998 the Corporation paid $65,000 (1997 - $35,000) to a corporation controlled by a shareholder with respect to share issue costs and $11,000 (1997 - $nil) to the same corporation with respect to general legal advice and management fees.

14. Income taxes:

The provision for income taxes differs from the amount that would be computed by applying the combined federal and provincial income tax rate of 44.6% to net loss for the following reasons:

Computed tax recovery	$ (310,000)
Increase (decrease) resulting from:	
Effect of losses, the benefit of which is not recognized	323,400
Other	(13,400)
	$ –

14. Income taxes (continued):

At December 31, 1998 the Corporation had non-capital loss carry-forwards of approximately $1,196,000 which are available to reduce future years' taxable income. These losses expire at various times from 2002 to 2006. The potential benefit of the above losses has not been recognized in the consolidated financial statements.

15. Commitments:

The Corporation leases properties under operating leases covering various periods up to 2006. The minimum future payments, excluding tenant operating costs, under these leases in each of the next five years are as follows:

1999	$ 215,308
2000	215,308
2001	215,192
2002	183,718
2003	148,160

In addition to minimum annual rentals, contingent rentals may be payable under certain store leases on the basis of sales in excess of stipulated amounts.

16. Uncertainty due to the Year 2000 Issue:

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date.

The effects of the Year 2000 Issue may be experienced before, on or after January 1, 2000 and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant system failure which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting the entity, including those related to the efforts of customers, suppliers or other third parties, will be fully resolved.

17. Subsequent events:

(a) Issuance of Common Shares:

Subsequent to December 31, 1998 the Corporation issued 700,000 Common Shares for gross proceeds of $140,000. Warrants to acquire 140,000 Common Shares at a price of $0.30 per share expiring December 2000 were attached to these shares.

(b) Stock options:

Subsequent to December 31, 1998 the Corporation issued 170,000 stock options to acquire Common Shares at an exercise price of $0.25 per share; 20,000 options expire on January 31, 2000 and 150,000 options expire on February 1, 2003.